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No. 87-1600

In the Supreme Court of the United States

OCTOBER TERM, 1987

ROLAND PENNINGTON, JR., AND JAMES M. DONNELL,
PETITIONERS

v.

ANN MCLAUGHLIN, SECRETARY OF LABOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether petitioners Pennington and Donnell, former trustees of an ERISA-covered employee benefit plan who failed to make payments to the plan as explicitly required by the terms of a consent order, were nonetheless in compliance with the consent order, and therefore not in contempt, on the ground that the corporate sponsor of the plan, which was wholly owned by petitioner Pennington, transferred funds for the benefit of the plan in fulfillment of a separate and preexisting obligation that the corporation had assumed.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A12) is reported at 832 F.2d 909. The orders of the district court denying the Secretary's motion for contempt (Pet. App. A14-A16), denying the Secretary's motion to reconsider and/or vacate the judgment (Pet. App. A17), and entering the consent order between the Secretary and petitioners (Pet. App. A18-A23) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on November 25, 1987. A petition for rehearing was denied on December 30, 1987 (Pet. App. A13). The petition for a writ of certiorari was filed on March 26, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).[1]

[1] Petitioners incorrectly cite 28 U.S.C. 1257(1) as the basis for this Court's jurisdiction (Pet. 2).

STATEMENT

1. Petitioners Pennington and Donnell were trustees of the Retirement Plan for Employees of Control Specialties, Inc. (Plan). Petitioner Pennington also is the Chairman of the Board and sole stockholder of Control Specialties, Inc. (CSI) (Pet. App. A2). From 1979 through July 1984, the Secretary of Labor conducted an investigation of the Plan under the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. (& Supp. III) 1001 *et seq.* (Pet. App. A2). On April 17, 1985, after that investigation uncovered numerous fiduciary breaches and prohibited transactions, the Secretary filed a complaint against petitioners and other trustees of the Plan in the United States District Court for the Southern District of Texas. On the same day, the parties submitted a proposed consent order, which was formally entered by the district court on August 29, 1985 (*id.* at A3).[2]

The consent order required that petitioners Pennington and Donnell make restitution to the Plan in the amount of $140,000, in three fixed annual payments beginning in 1985 (Pet. App. A22 (¶ 9)); that petitioner Pennington purchase from the Plan, in three equal annual payments beginning in 1985 and totaling $301,616.02, all common stock held by the Plan in J.E. Lonergan Company, a former acquisition target of Pennington's (*id.* at A21 (¶ 5)); and that petitioner Pennington pay to the Plan that portion of the interest payment on a $500,000 loan to the Plan from BancTexas-Houston (the Bank) that exceeded 12 percent (*id.* at A22 (¶ 10)).[3]

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[2] In addition to the Secretary, the parties to the decree are petitioners Pennington and Donnell, two other former trustees of the Plan (James R. Rosier and Wesley E. Fox), and the Plan itself. CSI is not a party to the decree.

[3] The Secretary had determined that the loan from the Bank " 'was imprudent to the extent that Pennington had caused the Plan to

In connection with the loan from the Bank to the Plan at an inflated interest rate, the Secretary limited the relief sought to the repayment of the excess interest, in light of an alternative arrangement for repayment of the loan that had been put in place. Specifically, when the loan was made in February 1983, CSI had agreed with the Bank to make annual contributions to the Plan of $150,000, to be used for repayment of the loan (Pet. App. A4 n.7). The Plan, in turn, promised to apply all contributions from CSI toward payment of the loan (*id.* at A4-A5). CSI further authorized the Bank to offset any outstanding loan debt of the Plan against any CSI funds held by the Bank in CSI's corporate accounts, in the event CSI breached its commitment to make the annual contributions to the Plan (*id.* at A4). In March 1983, CSI's board of directors ratified the commitment to contribute to the Plan at least $150,000 annually, until the loan was paid off (*id.* at A5).

2. When the Secretary completed his investigation in July 1984, CSI was current with its obligations under the agreement with the Bank, having made a $150,000 contribution to the Plan in September 1983 (Pet. App. A4 n.6). By late 1985, however, CSI had missed two annual contributions of $150,000 contemplated by the agreement (*id.* at A5). Accordingly, on January 29, 1986, the Bank exercised its option and offset funds in CSI's corporate account in the amount of $179,580.49, thus satisfying the Plan's indebtedness on the note (*ibid.*).[4] Shortly

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borrow the money at an interest rate then in the eighteen percent range in order to make mortgage loans (to various friends and acquaintances) at an interest rate of twelve percent' " (Pet. App. A4 n.6).

[4] Petitioners state that "[t]his offset occurred because the Plan Trustee failed to make payment on a note to the Bank guaranteed by CSI" (Pet. 3). That statement is flatly wrong. What CSI guaranteed was that it would make contributions to the Plan, not that the Plan would make good on the loan (Pet. App. A4 n.7). Further, nothing

thereafter, petitioners Pennington and Donnell failed to make payments to the Plan totaling more than $155,000 when they came due under the consent order in March and June 1986. They argued to the Secretary and subsequently in court that they should be credited with the Bank's offset of CSI funds as satisfying their obligations under the order (*id.* at A6, A9). The Secretary rejected that contention and advised Pennington's counsel that he considered all of the 1986 payment as unpaid (*id.* at A6). After making a formal demand for payment, the Secretary initiated contempt proceedings to secure compliance with the order (*id.* at A7).

3. The district court, after a hearing but without written opinion, denied the Secretary's motion for contempt (Pet. App. A16). The court apparently reasoned that the Bank's offset of CSI's corporate account discharged petitioners' obligations under the order because petitioner Pennington controls CSI (*id.* at A7, A14-A15).

The court of appeals reversed, holding that the district court abused its direction in refusing to hold Pennington and Donnell in civil contempt. Noting that the record unequivocally established that petitioners did not make the 1986 payments to the Plan required by the consent order (Pet. App. A9), the court agreed with the Secretary that the Bank's offset of CSI funds did not absolve petitioners of responsibility under the order because "[t]he offset was an entirely separate transaction which * * * ha[d] no effect on obligations flowing from the consent order" (*id.* at A10 (footnote omitted)). The court noted that nothing in the

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gave the bank any right to offset CSI's account as a consequence of any action by the Plan trustee. Rather, the guaranty of contribution gave the bank the right, "[u]pon the breach by Company [CSI] of this Guaranty," to offset CSI's account (*ibid.*).

record suggested that the Bank's action in offsetting CSI's funds was taken in order to secure compliance with the order, or that the Bank had authority to act for that reason, since neither the Bank nor CSI was a party to the consent order (*ibid.*). Rather, the offset was accomplished pursuant to a separate legal obligation of CSI (*id.* at A9-A10), and it yielded a benefit to the Plan that would "still have stood" even had petitioners satisfied their personal obligations under the consent order (*id.* at A11). For that reason, the court rejected petitioners' argument—and the district court's apparent reasoning—that no loss resulted to the Plan by recognition that the offset satisfied petitioners' personal restitutionary obligations (*ibid.*). The court also rejected petitioners' characterization of the offset funds in CSI's account as "Pennington's funds." The "vital distinction," according to the court, is that the "funds attached by the Bank pursuant to the guaranty of contribution were CSI's," not Pennington's. The offset of CSI's account, therefore, "was a separate flow of funds into the Plan" (*ibid.*).

The court similarly rejected petitioners' arguments that the Secretary, by characterizing the offset of CSI's account as fulfilling a separate legal obligation, was seeking to have the district court "adjudicate the rights and obligations of entities not bound by the consent order (CSI and the Bank)" or impermissibly look beyond the order's "four corners" to effectuate an "underlying, albeit unspecified, governmental purpose" (Pet. App. A10 n.12). Instead, the court stressed, it was petitioners who "sought to modify the terms of the consent order by asking the district court to credit them with payments made by CSI under the guaranty of contribution" (*ibid.*). The language of the consent order, said the court, simply cannot be construed "as either absolving CSI of its obligations under the guaranty of contribution or allowing Pennington and

Donnell to take credit for the contributions" (*ibid.*). And it was clear error for the district court to permit petitioners "to bootstrap their personal obligations onto [the] unrelated transfer of funds" arising from that guaranty (*id.* at A12).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Therefore, review by this Court is unwarranted.

Petitioners' primary assertion (Pet. 4-5), that the decision of the court of appeals conflicts with *United States* v. *Armour & Co.*, 402 U.S. 673 (1971), is without foundation. As explained by this Court in *United States* v. *ITT Continental Baking Co.*, 420 U.S. 223, 235 (1975), the lesson of *Armour*'s "four corners" rule is that in a subsequent enforcement proceeding a court may not interpret a consent order inconsistently with its plain language in order to effectuate the underlying purposes of one party to the agreement. In holding that petitioners here were not absolved of their undisputed obligations under the consent order through the Bank's offset of CSI's corporate funds, the court of appeals said nothing at all about any underlying purposes of any party to the agreement. Rather, the court simply enforced the literal terms of the consent order.

Moreover, as the court observed (Pet. App. A10 n.12), it was petitioners who, in arguing that their court-ordered restitutionary obligations were discharged by the unrelated transfer of funds between two non-parties to the order, implored the court to look beyond the consent order's "four corners" to interpret it inconsistently with its express terms. As the court emphasized, the guaranty of contribution was a separate, preexisting obligation on the part of

CSI, not Pennington or Donnell, to make payments to the Bank (*id.* at A10). That contractual duty was entirely distinct from Pennington's and Donnell's personal obligation, under the consent decree, to make the Plan whole for losses suffered as a result of their alleged fiduciary breaches. See 29 U.S.C. 1109 (fiduciaries shall be personally liable to make plan whole for losses). As the court aptly noted, petitioners seek "to construe the consent order as either absolving CSI of its obligations under the guaranty of contribution or allowing Pennington and Donnell to take credit for the contributions" (Pet. App. A10 n.12). Such a result—which would deprive the Plan of its court-ordered remedy—is not supported by the language of the consent order (*ibid.*). The court of appeals thus properly concluded that, in the face of clear and convincing evidence that petitioners had not made payments to the Plan required by the order, it was an abuse of discretion to deny the Secretary's motion for contempt.

Petitioners also cast this as a case in which the court of appeals failed to "accord the district court's weighing of the evidence * * * the deference required by the abuse of discretion standard" (Pet. 5). That argument is incorrect. The court of appeals properly recognized that it reviews a district court's refusal to hold a party in civil contempt under an abuse-of-discretion standard (Pet. App. A8), and it faithfully applied that standard. The court of appeals and the district court relied on precisely the same uncontroverted "evidence"—the guaranty of contribution, the offset pursuant to the guaranty, the terms of the consent order, and petitioners' failure to make payments to the Plan in March and June 1986 under that order—to assess whether petitioners had breached their obligations under the order. Based on that evidence, the court of appeals properly concluded that the offset did not satisfy petitioners' separate obligations under the consent order.

The district court hardly engaged in any weighing of the evidence, but simply misconstrued the terms of the consent order.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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